

FINAL STATEMENT OF REASONS OVERVIEW/NON-CONTROLLING SUMMARY

Adoption of Property Tax Rule 136, Limited Liability Companies as Qualifying Organizations for the Welfare Exemption

Update

The published version of Property Tax Rule 136 was amended by the Board of Equalization at public hearing on May 25, 2004, placed in the rulemaking file for 15 days, and mailed to interested parties for comment. The amendment to the Rule added subsection (b)(2) to define “qualifying organizations” to also include government entities, to allow a nonprofit limited liability company jointly owned by a nonprofit tax-exempt organization and a government entity to qualify its property for exemption from property taxes. The addition of subsection (b)(2) made it necessary to make a conforming amendment to subsection (c)(3).

Amendment to section (f) also is necessary because Senate Bill 1062 (Stats. 2003, Ch. 471, in effect January 1, 2004) revised welfare exemption claim filing requirements. The amendment to Section (f) deletes the words, “county assessor,” and substitutes “Board” and deletes the words, “duplicate copies” and substitutes “a copy.”

Following the 15-day public comment period, the Board considered the matter on June 30, 2004, and adopted the Rule as amended.

Specific Purpose

Proposed Rule 136 interprets and clarifies that organizations eligible for the welfare exemption from property taxation, “community chests, funds, foundations or corporations,” also include certain nonprofit tax-exempt limited liability companies. The proposed Rule defines a qualifying limited liability company as one that is wholly owned by one or more nonprofit tax-exempt organizations¹ meeting all the statutory requirements for exemption, or jointly owned by a nonprofit organization and government entity. Proposed Rule 136 is necessary to define the organizational and operational requirements of a nonprofit limited liability company eligible to claim the welfare exemption from property taxation on its property.

Factual Basis

The proposed Rule is in response to a petition for regulatory action pursuant to Government Code section 11340.6, filed with the Board on May 9, 2003, by Ms. Ingrid Mittermaier, an attorney with the law firm of Silk, Adler & Colvin. The petition requested that the Board of Equalization exercise its rule making authority to adopt a regulation that would clarify that nonprofit limited liability companies wholly owned by qualifying nonprofit tax-exempt entities,

¹ The term, “tax-exempt” means an organization exempt from federal income tax under section 501(c) (3) of the Internal Revenue Code, or exempt from state franchise and income taxes under section 23701d of the Revenue and Taxation Code.

as specified in section 214, subdivision (a) of the Revenue and Taxation Code², are organizations qualified for the welfare exemption. Such qualifying limited liability companies would be eligible to claim the welfare exemption on their property.

The Board also is sponsoring legislation in the current session of the Legislature to amend section 214 to clarify that limited liability companies may qualify for the exemption. Assembly Bill 3073 proposes to amend section 214 et seq. to add limited liability companies as an entity qualified for the welfare exemption. The proposed amendment would update section 214, consistent with section 4(b) of Article XIII of the California Constitution, which references “other entities” eligible for the exemption, and was adopted by the voters to authorize the legislature to exempt the property of all qualifying nonprofit organizations. Section 214, as amended, would be consistent with the voters’ intent in their adoption of 4(b) of Article XIII of the California Constitution in 1974, and of the original constitutional amendment (section 1c of former Article XIII) in 1944. While the Board’s adoption of the proposed Rule is not dependent on the enactment of the legislation to amend section 214, the legislation would be consistent with existing statutory language, which identifies specific legal entities eligible for the exemption. The Board anticipates that Assembly Bill 3073 will be enacted into law by the Legislature and will take effect on January 1, 2005. Accordingly, the Board intends that the proposed Rule 136 also be effective on January 1, 2005.

Rule 136 interprets sections 4(b) and 5 of Article XIII of the California Constitution³ and sections 214 et seq., 254, 254.5, 254.6, 255, 261, 270, 271, 75.21 and 75.22 of the Revenue and Taxation Code. Section 4 (b) of Article XIII provides for the exemption from property taxation of property used exclusively for religious, hospital, or charitable purposes that is owned or held in trust by qualifying nonprofit organizations operating for those purposes. Section 5 of Article XIII extends the exemption to buildings under construction, land required for their convenient use and equipment in them if the intended use would qualify the property for exemption. Section 214 implements the aforementioned constitutional provisions and imposes a number of requirements that must be met before property is eligible for exemption.

The constitutional requirement⁴ that property is to be owned and used exclusively for exempt purposes by qualifying nonprofit organizations to be eligible for exemption is reiterated in subd. (a) of Section 214. Section 214 exempts property used exclusively for religious, hospital, scientific or charitable purposes that is owned and operated by nonprofit tax-exempt organizations organized and operated for those purposes, specifically identified as community chests, funds, foundations or corporations. The legal entities enumerated in section 214 were the types of nonprofit organizations in existence in 1944 when the voters approved the constitutional amendment authorizing the welfare exemption, section 1c of former Article XIII.⁵ These organizations are the same entities that have been identified in section 214 since its enactment in 1945.

The electorate readopted the constitutional amendment authorizing the welfare exemption from property taxation in substantially the same form in 1974. But section 4(b) of Article XIII of the

² All section references are to the Revenue and Taxation Code unless otherwise specified.

³ Section 5 of Article XIII extends the exemption to buildings under construction, land required for their convenient use and equipment in them if the intended use would qualify the property for exemption.

⁴ California Constitution, Article XIII, Section 4 (b).)

⁵ Amendment No. 17, Taxation exemption of religious, hospital and charitable organizations.

California Constitution referenced qualifying entities with both specific and general language. Section 4(b) of Article XIII, provides, in relevant part, that the Legislature may exempt from property taxation, “property used exclusively for religious, hospital, or charitable purposes and owned or held in trust by corporations or *other entities*,” that meet certain requirements. The voters’ intent, in adopting the original Constitutional amendment [section 1c of former Article XIII] in 1944 and section 4(b) of Article XIII in 1974, was to allow exemption from property taxes to all nonprofit tax-exempt organizations and their properties that met the statutory requirements.

On October 15, 2003, the Board of Equalization approved publication of the proposed Rule, and scheduled a public hearing for March 23, 2004. A notice of proposed regulatory action and public hearing was mailed to interested parties on January 30, 2004, in compliance with section 11346.4(a)(1) through (a)(4). The Board postponed the public hearing and provided notice of the postponement on the Board’s web site and by email to interested parties. The public hearing on the proposed Rule was subsequently rescheduled to May 25, 2004. The Board provided notice of the rescheduled public hearing on the Board’s web site and by email to interested parties on April 16, 2004.

Local Mandate Determination

The State Board of Equalization has determined that the Rule does not impose a mandate on local agencies or school districts.

Response to Public Comment

On May 25, 2004, the State Board of Equalization held a public hearing on the proposed adoption of Rule 136. Following the hearing, the Board approved amendments to the Rule, and the Rule was placed in the rule-making file for 15 days for further public comment. The Board considered the matter on June 30, 2004 and the Rule was adopted as amended.

Written Comments

Mark T. Schieble, Foley & Lardner LLP.

Mr. Schieble supported the proposed Rule as published, but urged an amendment to allow exemption to a limited liability company owned by nonprofit organizations and government entities in a letter, dated May 24, 2004. He indicated that health care providers, including nonprofit corporations and government entities (health care districts, public universities, county hospitals, public university hospitals and medical schools) increasingly engage in joint ventures to provide new health care services. The limited liability company structure is generally preferred for such joint ventures, but since this entity has not been eligible for exemption from property taxes under section 214, it has not been used for this purpose. Mr. Schieble asserted that since the property of government entities is exempt from property taxation,⁶ these entities “should be entitled to the same treatment as nonprofit corporations” under the proposed Rule,

⁶ Article XIII, section 3 of the California Constitution exempts: property owned by the state (subsection (a)); property owned by a local government (subsection (b)); and, property used exclusively for public schools, community colleges, state colleges and state universities (subsection (d)).

when participating in joint ventures with nonprofits. Mr. Schieble recommended the following changes to the published Rule.

Subsection (b)

Renumber subsection (b) as (b)(1) and add a new subsection (b)(2) to read:

(b)(2) Qualifying Organization. A qualifying organization is also a government entity that is exempt from property taxation under section 3 of Article XIII of the California Constitution, as to property owned by the state under subdivision (a), or as to property owned by a local government under subdivision (b), or as to property used exclusively for public schools, community colleges, state colleges and state universities. A limited liability company is a qualifying organization if one or more of its members is a government entity, as specified, and all other members are exempt under section 501(c) (3) of the Internal Revenue Code or under section 23701d of the Revenue and Taxation Code and qualify for exemption under section 214 of the Revenue and Taxation Code.

Subsection (c)(3)

The amendment to subsection (b) requires a conforming change to subsection (c)(3) concerning the requisite organizational language in the formative document of a qualifying limited liability company. The amendment to subsection (c)(3) deletes the language, “under section 214 and exempt under section 501(c)(3) of the Internal Revenue Code or section 23701d of the Revenue and Taxation Code” and substitutes, “as specified in subsections (b)(1) and (b)(2) of this rule.”

Staff Response: No response is required to this comment in support of adoption.

Oral Comments

Mr. Thomas Parker, Deputy County Counsel (Eldorado County), representing the California Assessors Association

Mr. Parker stated at the public hearing on proposed Rule 136 on May 25, 2004, that the California Assessors Association supports the Rule and the proposed amendments thereto.

Staff Response: No response is required to this comment in support of adoption.

Small Business Impact

The State Board of Equalization has determined that the proposed Rule does not and will not have a significant adverse impact on small businesses.

Adverse Economic Impact on Private Persons/ Businesses Not Including Small Business

No impact.

Federal Regulations

There are no comparable Federal regulations.

Alternatives Considered

By its motion to adopt the Rule as amended pursuant to public comment, the Board determined that no alternative to the Rule would be more effective in carrying out the purpose for which the Rule is proposed or would be as effective and less burdensome to affected private persons than the adopted regulation.